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No. 90-659

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

KEITH R. GOLLUST, PAUL E. TIERNEY, JR., AUGUSTUS K. OLIVER, GOLLUST, TIERNEY AND OLIVER, GOLLUST & TIERNEY, INC., CONISTON PARTNERS, CONISTON INSTITUTIONAL INVESTORS, BAKER STREET PARTNERS, WJB ASSOCIATES and HELSTON INVESTMENT INC.,

Petitioners,

—v.—

IRA L. MENDELL, in behalf of Viacom Inc. and, alternatively, Viacom International Inc., VIACOM INC. and VIACOM INTERNATIONAL INC.,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR PETITIONERS

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QUESTION PRESENTED

Whether the court below erred in ruling that the phrase in Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b), granting standing to bring an action thereunder to "the owner of any security of the issuer" can be interpreted to include a "former owner" of such securities, and thereby holding that Respondent could maintain an action under Section 16(b) on behalf of an issuer of securities after he had ceased to own any of its securities?

PARTIES TO THE PROCEEDING

All parties to this proceeding are identified in the caption.* In addition to these parties, the Securities and Exchange Commission participated in the proceedings before the United States Court of Appeals for the Second Circuit below as *amicus curiae.*

* The following information is provided pursuant to Rule 29.1 of this Court: Gollust, Tierney and Oliver, Inc., the successor by merger to Petitioner Gollust & Tierney, Inc., is owned by Keith R. Gollust and Paul E. Tierney, Jr., and has no subsidiaries; Petitioner Helston Investment Inc. is wholly owned by Coniston North Atlantic International Corp. and has no subsidiaries.

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BRIEF FOR PETITIONERS

This brief is respectfully submitted by petitioners Keith R. Gollust, Paul E. Tierney, Jr., Augustus K. Oliver, Gollust, Tierney and Oliver, Gollust & Tierney, Inc., Coniston Partners, Coniston Institutional Investors, Baker Street Partners, WJB Associates and Helston Investment Inc. ("Petitioners"), seeking reversal of a decision of the United States Court of Appeals for the Second Circuit, entered in this proceeding on July 25, 1990, which reversed an order of the United States District Court for the Southern District of New York grant-

ing summary judgment in favor of Petitioners on the ground that Respondent lacked standing to maintain this action.

OPINIONS BELOW

The opinions delivered in the Court of Appeals for the Second Circuit (1a[1]) are reported at 909 F.2d 724 (2d Cir. 1990). The Opinion and Order of the District Court for the Southern District of New York granting summary judgment in favor of Petitioners (30a) is reported unofficially at [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,086 (S.D.N.Y. Nov. 8, 1988). The Final Judgment of the District Court (34a) is unreported. The Opinion and Order of the District Court denying Respondent's motion pursuant to Fed. R. Civ. P. 60(b) for relief from the Final Judgment (35a) is reported unofficially at [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,477 (S.D.N.Y. May 23, 1989).

JURISDICTION

The judgment of the Court of Appeals for the Second Circuit was entered on July 25, 1990. The Petition for a Writ of Certiorari was filed on October 23, 1990, and was timely under 28 U.S.C. § 2101(c). The Petition for a Writ of Certiorari was granted by an order filed on January 7, 1991, which is reported unofficially at 111 S. Ct. 669 (1991). The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTE INVOLVED

This case involves Section 16(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78p(b), which provides:

1 References to the Appendices to the Petition for a Writ of Certiorari are cited "__a." References to the Joint Appendix are cited "JA __."

(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

15 U.S.C. § 78p(b). The phrase "such beneficial owner, director, or officer" in Section 16(b) refers to Section 16(a) of the Exchange Act, 15 U.S.C. § 78p(a), which imposes certain reporting obligations on "[e]very person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to [Section 12 of the Exchange Act, 15 U.S.C. § 78*l*], or who is a director or an officer of the issuer of such security . . . ."

STATEMENT OF THE CASE

A. Facts

Respondent Ira L. Mendell ("Respondent") filed his original Complaint herein in behalf of Viacom International Inc. ("International")[2] in January 1987, alleging that he was then a holder of common stock of International, a company whose shares were listed on the New York Stock Exchange and registered under Section 12 of the Exchange Act, 15 U.S.C. § 78*l*, and that he was entitled to assert a Section 16(b) claim on behalf of International against Petitioners arising out of their purchases and sales of International stock in 1986.[3] Respondent did not allege that Petitioners were true "insiders" subject to Section 16(b) in the sense that they had been officers or directors of International or in any way controlled or influenced the affairs of International. Instead, the basis for Respondent's claim is that "[f]or the purposes of Section 16(b), all defendants . . . constituted a single or one beneficial owner of more than ten per centum of the common stock of" International, who, among other things, "operated as a single unit and as a single beneficial owner within the meaning of Section 16(b) and made their official filings with the Securities and Exchange Commission . . . as a unit." Amended Complaint ¶¶ 6, 15; 40a, 42a.[4]

2 Respondents International and Viacom, Inc., its parent company, were nominal defendants in the District Court below and nominal appellees before the Court of Appeals, and have not actively participated in this action.

3 The allegations relating to Petitioner's alleged liability under Section 16(b), as opposed to Respondent's standing, were essentially identical in the original Complaint, which is not reproduced in the Appendices to the Petition for a Writ of Certiorari or in the Joint Appendix, and the Amended Complaint, which is reproduced in the Appendices to the Petition for a Writ of Certiorari.

4 The Complaint did not allege that any one Petitioner in fact owned ten percent or more of International's common stock at any time. Rather it contended that, because Petitioners "made their official filings with the [Commission] as a unit, and through the identical agent and representative and attorney in fact and in a single document" (Amended Complaint ¶ 15; 42a)—*i.e.*, were required to report their combined shareholdings as a single "beneficial owner" for purposes of Section 13(d) of the Exchange Act, 15 U.S.C. § 78m(d)—they were also a single "beneficial owner" of such shares for purposes of Section 16. Respondent's position on this issue has been rejected repeatedly by the courts. *See Mayer v. Chesapeake Ins. Co.*, 877 F.2d 1154, 1162 (2d Cir. 1989), *cert. denied*, 110 S. Ct. 722 (1990); *Rothenberg v. Jacobs*, [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,199 (S.D.N.Y. Jan. 11, 1989), *aff'd mem.*, 888 F.2d 126 (2d Cir. 1989); *C.R.A. Realty Corp. v. Goodyear Tire & Rubber Co.*, 705 F. Supp. 972, 973-78 (S.D.N.Y.), *aff'd mem.*, 888 F.2d 125 (2d Cir. 1989). The Securities and Exchange Commission has recently adopted new rules that for the first time would apply the "beneficial ownership" rules under Section 13(d) to determine whether a person is a beneficial owner of more than ten percent of any class of equity securities under Section 16. *See* Ownership Reports and Trading By Officers, Directors and Principal Stockholders, Exchange Act Release No. 34-28869, at 122-24 (Feb. 8, 1991) (newly adopted Rule 16a-1(a)(1), to be codified at 17 C.F.R. § 240.16a-1(a)(1)). However, transactions occurring prior to the May 1, 1991 effective date of the new rule would be governed by prior law. *Id.* at 94.

In June 1987, International was acquired by Arsenal Holdings, Inc. (now named Viacom Inc. and referred to herein as "Viacom")—an entity controlled by National Amusements, Inc. ("National Amusements")—through a merger with a subsidiary of Viacom pursuant to which International became a wholly owned subsidiary of Viacom and the shareholders of International received a combination of cash and Viacom securities in exchange for their shares of International. *See* Proxy Statement of International/Prospectus of Viacom, dated May 4, 1987, annexed to Affidavit of Edwin B. Mishkin, verified May 27, 1988 ("Proxy Statement") at 1-2; JA 14-JA 16; Viacom Annual Report on Form 10-K for the year ended December 31, 1987, at 2; JA 31. As a consequence of the merger, Respondent ceased to be a shareholder of International, becoming instead a security holder of its new parent corporation, Viacom.

Respondent's Amended Complaint, filed in behalf of International and, alternatively, Viacom in March 1988, alleged that as a result of the merger, Respondent was now a holder

of stock of Viacom. Amended Complaint ¶ 9; 40a. The Amended Complaint also alleged that by reason of the merger, Viacom became "the issuer within the meaning of Section 16(b)." *Id.* at ¶ 20; 43a. Finally, realizing that he may be held to lack standing, Respondent alleged alternatively that his action was brought as a "double-derivative" lawsuit on behalf of International. *Id.* at ¶ 24; 44a.

As the record demonstrates, the acquisition of International by Viacom was not in any way a reaction to Respondent's lawsuit. Instead, it was a bona fide arm's-length business transaction between previously unaffiliated parties that resulted from events that began months before Respondent's suit was filed. *See* Proxy Statement at 9-12; JA 18-JA 24 (describing a series of bids for International beginning in September 1986 that were made by two competing bidders, one led by senior managers of International and the other by National Amusements). Moreover, the transaction was not an "involuntary" one; rather it was a consensual merger that was required to be, and was, approved by a majority vote of holders of International common stock, over 80 percent of which was held by shareholders who were independent of National Amusements or its affiliates (Proxy Statement at 5; JA 18). Dissenting shareholders were afforded appraisal rights under Ohio law, Proxy Statement at 16; JA 25-JA 26, which Respondent did not exercise.

Following the consummation of the merger and the filing of the Amended Complaint, Petitioners moved for summary judgment on the ground that Respondent no longer had standing to sue because he had ceased to be a holder of securities of International—the issuer on whose behalf the suit was brought—and that Respondent could not escape his lack of standing by asserting a "double-derivative" action.

B. The District Court's Standing Decision

On November 8, 1988, the District Court, relying on prior Second Circuit precedent, issued an Opinion and Order holding that "[b]ecause, as a matter of law, plaintiff does not have standing to prosecute his § 16(b) claim against defend-

ants, their motion [for summary judgment] is granted." *Mendell v. Gollust*, [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,086, at 91,086 (S.D.N.Y. Nov. 8, 1988); 31a.

As an initial matter, the District Court noted that Section 16(b) actions may be prosecuted "only by the issuer itself or the holders of its securities," *id.* at 91,086; 32a, and because Respondent no longer owned any International securities, he had no standing to maintain a Section 16(b) action on behalf of International, *id.* at 91,087; 33a.

The District Court then turned to whether Respondent had standing to sue as a security holder of the new parent corporation of the issuer. Noting that International remained a viable corporate entity, and that it had a shareholder—Viacom—the District Court held that the explicit language of Section 16(b) limited the right to sue to either International or Viacom. *Id.* at 91,087; 33a. Respondent, being neither, therefore lacked standing to maintain his action under Section 16(b). *Id.*[5]

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5 The District Court also rejected Respondent's attempt to circumvent the express standing requirements of Section 16(b) by labelling the lawsuit a "double-derivative" action, stating that "shareholders of a shareholder are not the issuer or the owners of the issuer's securities, and therefore, by the statute's own terms, they are not entitled to sue under § 16(b)." *Id.* at 91,087; 33a.

After filing his first notice of appeal from the District Court's November 8, 1988 Opinion and Order, but before any action was taken on Respondent's appeal, in January 1989, Respondent decided on a new tactic: to regain standing to sue, he went into the market and purchased a $1000 bond of International that was part of an issue that had been offered to the public in July 1988, well before the District Court's November 8, 1988 Opinion and Order. Respondent advised the Second Circuit of his new "status" as a security holder of International and of his intention to make a motion to vacate the District Court's judgment, and the parties thereafter stipulated to withdraw Respondent's appeal from active consideration by the Second Circuit in order to allow Respondent to make his motion pursuant to Fed. R. Civ. P. 60(b), which was made in March 1989.

On May 23, 1989, the District Court denied Respondent's Rule 60(b) motion stating that his "after-the-fact stratagem devised following an

C. The Court of Appeals' Decision

After oral argument was held before the Court of Appeals, that court requested the Securities and Exchange Commission (the "Commission") to submit an *amicus curiae* brief setting forth its views on Respondent's standing under Section 16(b). *Mendell v. Gollust*, 909 F.2d 724, 726 (2d Cir. 1990); 6a. The Commission responded by submitting a brief in which it acknowledged that decisions of the other Courts of Appeals (as well as previous cases from the Second Circuit itself) had uniformly denied standing to plaintiffs in situations similar to that of the Respondent here, but nevertheless argued in favor of Respondent's standing principally in order to vindicate what it viewed as the "broad remedial purpose" of Section 16(b). Brief for the Commission, *amicus curiae*, at 2, *Mendell v. Gollust*, 909 F.2d 724 (2d Cir. 1990) (No. 89-7068).

On July 25, 1990, the Court of Appeals panel, by a 2-1 decision, reversed the District Court's November 9, 1988 ruling granting Petitioners summary judgment based on Respondent's lack of standing.[6]

adverse opinion" was not a sufficient basis, under Rule 60(b)(6), to vacate the District Court's prior order and judgment. *Mendell v. Gollust*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,477, at 93,051 (S.D.N.Y. May 23, 1989); 38a. Further, in response to Respondent's counsel's plea that he did not think of having Respondent purchase the International bond sooner, the District Court stated that "[c]ounsel's ignorance of the law cannot form the basis for an order under Fed. R. Civ. P. 60(b)(1)." [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,477, at 93,050; 37a. Respondent thereupon filed a second notice of appeal challenging the District Court's denial of his Rule 60(b) motion.

6 The Court of Appeals did not reach the question of the District Court's rejection of Respondent's standing argument based upon an alleged "double derivative" action, 909 F.2d at 731; 18a, but affirmed the District Court's denial of Respondent's Rule 60(b) motion (*see* note 5, *supra*), *id.* at 731-32; 18a-19a. These issues were not raised or addressed in the Petition for a Writ of Certiorari or in Respondent's Brief in Opposition, and are not addressed in this Brief.

1. The Majority Opinion

The opinion of the majority made clear that the focal point of its decision was not the actual language of the standing provisions of Section 16(b) at issue here, but what it perceived to be the broad remedial purposes underlying Section 16(b). The opinion began by discussing the legislative history of Section 16(b) and the purposes of the statute, 909 F.2d at 726-27; 7a-8a, and reviewed prior case law involving the construction of Section 16(b) purportedly indicating that where Section 16(b)'s terms are susceptible of differing constructions, it should be construed broadly, *id.* at 727-28; 8a-10a.

Turning to the standing requirements of Section 16(b), the majority stated that "the question of whether a plaintiff has standing to bring suit is, in part, determined by whether the policy behind the statute is best served by allowing the claim." *Id.* at 729; 12a. Although the majority acknowledged that "the amount or value of a [Section 16(b)] plaintiff's holdings or his motives for bringing suit are not relevant" to the question of standing, *id.* at 729; 12a, it also reasoned that, in cases such as this, standing could be determined on the basis of an assessment of the likelihood that the statute would be enforced by the available plaintiffs, *id.* at 729; 13a (in cases where original issuer survives merger as wholly owned subsidiary of a new parent corporation, "[a]s a practical matter it is unrealistic to believe that the issuing corporation will bring an action against itself or its insiders").

Only after concluding that, as a matter of policy, plaintiffs such as Respondent here should be granted standing in Section 16(b) cases did the majority actually address the contention that the statutory language did not support this conclusion. *Id.* at 730-31; 15a-16a. In what amounted to nothing more than judicial redrafting of legislation, the majority stated that, because the reference to the "owner of any security of the issuer" in Section 16(b) was not modified by the word "current," the statute did not specifically bar the maintenance of Section 16(b) suits by "former" owners of the issuer's securities. *Id.* at 730; 15a.

The majority completely avoided any analysis of the reasoning of earlier decisions of other courts (including the Second Circuit itself) that had uniformly held that a Section 16(b) plaintiff must remain a security holder of the issuer throughout the litigation, and that if a security holder of the issuer ceases for any reason to own such securities, or if the securities held are those of a parent or grandparent corporation rather than the original issuer, he does not have standing to maintain the action. Although its decision was plainly inconsistent with those earlier decisions, the majority sought to distinguish them factually on the ground that this case presents a "novel situation" in that Respondent's shares of the issuer corporation were exchanged for securities of its new parent corporation and therefore the issuer's former shareholders had a "continuing interest in maintaining suit in behalf of the issuer." *Id.* at 730-31; 16a-17a.

Finally, although the record below plainly demonstrated that the acquisition of International by Viacom (a previously unrelated party) was not in any way related to this lawsuit—and Respondent had not even asserted that it was—the majority stated that it could not "help but note that the incorporation of Viacom and the merger proposal occurred after plaintiff's § 16(b) claim was instituted. Hence, the danger of such intentional restructuring to defeat the enforcement mechanism incorporated in the statute is clearly present." *Id.* at 731; 17a.

2. The Dissenting Opinion

In a dissenting opinion, Senior District Judge Milton Pollack (sitting by designation) noted that "[t]he majority's ruling departs from the unequivocal terms of the statute to be administered and from the prior case law of this Court applying the statute, and it conflicts with rulings of the other Circuits which have addressed the requirements of the statute." *Id.* at 732; 20a. The dissent noted that Respondent "no longer satisfies the plain statutory requirement—ownership of securities of the issuer," *id.* at 732; 21a, and that the decision of the District Court was consistent with prior case law of the

Second Circuit and with rulings from the Seventh and Ninth Circuits—the only other circuits to address the issue—as well as with "traditional rulings in other contexts" holding that continuing ownership of securities of the issuer is required in order to present a justiciable case or controversy. *Id.* at 733; 22a-23a.

The dissent also noted that the Commission itself recognizes "that qualifying former shareholders to sue, either judicially or by rule-making, is a marked departure from the pre-existing jurisprudence under § 16(b)." *Id.* at 735; 26a-27a. The dissent observed that "Congress simply has not delegated to the courts the authority to qualify a 'former' owner as an 'owner of any security of the issuer,' " *id.* at 735; 27a, and "[t]here is simply no indication in any of the legislative history of § 16(b) that the plain meaning of the words 'owner of any security of the issuer' was meant to include or even could include one who is no longer the owner of any security of the issuer," *id.* at 735; 28a. Accordingly, the dissent urged the court to " 'reject [Respondent's] invitation to draft "judicial legislation" to grant him standing.' " *Id.* at 736; 29a (citation omitted).

SUMMARY OF ARGUMENT

Prior to the decision of the Court of Appeals below, it had been well-established that a plaintiff bringing a Section 16(b) action in behalf of an issuer must not only have the status of "the owner of any security of the issuer," as required by the statute, at the commencement of the suit, but must also maintain that status throughout the litigation. This "continuous ownership requirement" is compelled by the structure and legislative history of the statute, which demonstrate a clear intent to vest control of such litigation only in parties who have a financial interest in the outcome; by the narrowly circumscribed standing provisions of Section 16(b), which are unique among the civil liability provisions of the federal securities laws in excluding the Commission from the enforcement scheme, rendering it anomalous for a private party without a

financial interest to maintain a suit that the Commission could not bring itself; by principles applicable to shareholder derivative litigation generally, under which a shareholder is permitted, by virtue of his financial interest in the outcome, to step into the shoes of the corporation to seek relief on its behalf; and by the case or controversy requirement of Article III of the Constitution, which requires a plaintiff to have a financial interest in the outcome at all stages of the litigation.

Consistent with the continuous ownership requirement, the language of Section 16(b), which accords standing to "the owner of any security of the issuer," could not be clearer, admitting of no other interpretation than that suit must be brought and maintained by a "current owner." Nevertheless, the Court of Appeals grafted an exception onto the clear words of Section 16(b) to accord standing to "former owners" of securities of the issuer. In order to do so, the Court of Appeals—in the guise of furthering the "policy behind the statute"—distorted the plain words of the statute to create an ambiguity where none existed. The Court of Appeals' judicial legislation violated the well-established principle that, when Congress has spoken clearly, a court may not rewrite the words of the statute to cure a perceived defect in the statutory scheme.

The Court of Appeals' redrafting of Section 16(b) also ignored the Section 16(b) jurisprudence that has long been laid down by this Court. In recognition of the unique status of Section 16(b) as a strict liability statute with harsh consequences even for innocent conduct, this Court has required that its provisions be applied narrowly, with any ambiguities resolved against liability. Indeed, every time this Court has addressed Section 16(b), it has resolved uncertainties concerning the interpretation of the statute *against* liability. Thus, the Court of Appeals only compounded its error by resolving in favor of liability an ambiguity that was of its own making.

The Court of Appeals also plainly erred in asserting that the merger which deprived Respondent of his share ownership in the issuer presented a "danger of . . . intentional

restructuring to defeat the enforcement mechanism incorporated in the statute." The record unequivocally shows that the merger involved here was a bona fide arm's-length transaction with a valid business purpose and was completely unrelated to this lawsuit, and Respondent has not even asserted otherwise. The statutory enforcement scheme was also unimpeded by the merger, since the two parties with standing to sue under the statute—International and Viacom—were free to pursue the matter if they so chose. Moreover, even if, in cases such as this, neither the issuer nor its sole shareholder chooses to pursue an action under Section 16(b), any danger of abuse of inside information is precluded by the numerous other statutory provisions prohibiting insider trading that may be enforced by the Commission or injured parties.

Finally, the Court of Appeals completely failed in its attempt to create a factual distinction between this case and the other cases that have uniformly denied standing to parties who do not have security holder status in the issuer, either at or after the commencement of the litigation. There is simply no principled basis to distinguish this case from any other case denying standing to plaintiffs who lost ownership of their securities in the issuer by a corporate merger or who sought to commence or maintain a Section 16(b) suit as security holders of a corporation that is not in fact the issuer of their securities but is instead the parent (or grandparent) of that issuer.

ARGUMENT

THE COURT OF APPEALS WRONGLY HELD THAT RESPONDENT HAS STANDING TO MAINTAIN THIS ACTION UNDER SECTION 16(b)

The specific issue before the Court of Appeals was whether, under Section 16(b), an owner of a security of the issuer has standing to continue a Section 16(b) action once he no longer owns any security of the issuer. The broader issue presented in this case is whether the federal courts have the power to expand upon the unambiguous language of Section 16(b) to accord standing to sue to one who does not meet the statutory requirement in order to further what those courts perceive to be the remedial purposes of the statute. The Court of Appeals majority below, in an unprecedented opinion, incorrectly answered both questions in the affirmative.

A. A Security Holder Of The Issuer Who Commences An Action Under Section 16(b) Must Maintain His Status As A Security Holder Of The Issuer Throughout The Litigation

Prior to the decision of the Court of Appeals majority below, the courts had been unanimous in requiring that a plaintiff bringing a Section 16(b) action in behalf of the issuer must not only have the status of "the owner of any security of the issuer," as required by the statute, at the commencement of the suit, but must also maintain that status throughout the litigation. *See Rothenberg v. United Brands Co.*, [1977-78 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,045, at 91,691-92 (S.D.N.Y. May 11, 1977) (plaintiff lost standing to maintain Section 16(b) action after suit commenced when his shares in the issuer were sold to parent of issuer in short-form "squeeze-out" merger), *aff'd mem.*, 573 F.2d 1295 (2d Cir. 1977); *Portnoy v. Kawecki Berylco Indus., Inc.*, 607 F.2d 765, 767 (7th Cir. 1979) (plaintiff lost standing to maintain Section 16(b) action after his shares in the issuer were "cashed out" in merger, despite ownership of securities of new grandparent of issuer both before and after merger); *Staffin v. Greenberg*, 509 F. Supp. 825, 840 (E.D. Pa. 1981) ("[T]he law requires that to maintain a derivative action under section 16(b) a plaintiff must have and maintain his standing as a shareholder at the commencement of the law suit and throughout the litigation."), *aff'd on other grounds*, 672 F.2d 1196 (3d Cir. 1982); *see also Lewis v. McAdam*, 762 F.2d 800, 803 (9th Cir. 1985) (per curiam) (no standing to shareholder of parent of surviving corporation who commenced suit after issuer was acquired through merger); *Untermeyer v. Valhi*, 665 F. Supp. 297 (S.D.N.Y. 1987) (same), *aff'd mem.*, 841 F.2d 1117 (2d Cir.), *aff'd on reh'g*, 841 F.2d 25 (2d Cir.), *cert. denied*, 488 U.S. 868 (1988); *Herrmann v. Steinberg*, 812 F.2d 63, 67 n.4 (2d Cir. 1987) (in remanding to district court, court notes that as a "threshold matter" plaintiffs "must establish that they have been [the issuer's] shareholders throughout this litigation").

Notwithstanding this overwhelming precedent, the Court of Appeals majority below asserted that the continuous ownership requirement "is not mandated either by the statutory language or by the cited cases." 909 F.2d at 730; 15a. The majority's assertion flies in the face of the structure and legislative history of the statute, principles generally applicable to derivative litigation and constitutional principles governing standing.

The requirement of continuous ownership after the commencement of the suit is implicit in the statutory requirement that "[s]uit . . . may be instituted . . . by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter." Exchange Act § 16(b), 15 U.S.C. § 78p(b). This scheme entrusts Section 16(b) actions not brought by an issuer only to persons who have the statutorily defined financial interest in the outcome of the litigation. The fact that "the owner of any security of the issuer" may not only commence an action that an issuer has failed to bring, but may step in during the course of an action that was brought initially by the issuer if the issuer fails to pursue

it "diligently," makes clear that security owner status, and the financial incentive it provides, is important at *all* stages of the litigation, not just at the threshold. The statute simply cannot be read to require that a plaintiff need be a security owner of the issuer only at the instant he brings the suit and that he may continue the suit after ceasing to have the statutory status.

The legislative history of Section 16(b) fully supports this reading of the statute. Thomas G. Corcoran, one of the principal draftsmen of the Exchange Act, indicated in testimony before Congress that the purpose of the provision giving standing to security holders was to provide an incentive to sue to parties who would benefit financially from a recovery. Responding to concerns expressed that Section 16(b) would be difficult to enforce, Corcoran stated:

> . . . . You have said to all of the stockholders of the company, "You can recover any of this profit *for your own account*, if you find out that any such transactions are going on."
>
> * * * *
>
> The fact that the *stockholders, with an interest*, are permitted to sue to recover that profit for the benefit of the company, puts anyone doing this particular thing, in the position of taking risk that *somebody, with a profit motive* will try to find out.
>
> The section is a deterrent, and you will in some cases actually catch violators.

Hearings on H.R. 7852 and H.R. 8720 Before the House Comm. on Interstate and Foreign Commerce, 73d Cong., 2d Sess. 136-37 (1934) (emphasis added). Thus, in providing standing not just to the issuer, but also to its security holders, Congress sought to ensure that such actions are maintained by parties with a financial interest in the outcome of the action—a purpose that is completely defeated if a plaintiff who does not have that status is permitted to maintain the suit.

The continuous ownership requirement is also consistent with Section 16(b)'s enforcement scheme. Where Congress thought it appropriate to expand standing to enforce securities laws beyond the parties who would benefit financially from recovery, it has done so by giving the Commission enforcement authority. *See, e.g.*, Investment Company Act of 1940 § 36(b), 15 U.S.C. § 80a-35(b) (standing to sue advisor and others for breach of fiduciary duty given solely to the Commission and security holders); Insider Trading Sanctions Act of 1984, Exchange Act § 21A, 15 U.S.C. § 78u-1 (action for violation of prohibition on insider trading may be brought by the Commission). Section 16(b), however, is one of the few areas in which the Commission has *no* enforcement authority whatsoever, even under the broad delegation of authority to the Commission under Exchange Act § 21, 15 U.S.C. § 78u, to take action against violations of the Exchange Act, since Section 16(b) cannot be the basis for a "violation."[7] *See, e.g.*, *Commonwealth Energy System*, SEC No-Action Letter (publicly available Nov. 2, 1989) (WESTLAW, FSEC-NAL database) ("Because enforcement of Section 16(b) rests exclusively with private litigants and the

7 Section 16(b) is not worded as a prohibition on short-swing trading. The operative provision simply provides that "any profit realized by [any officer, director or ten percent beneficial owner] from any purchase and sale, or any sale and purchase, of any equity security of [the] issuer . . . within any period of less than six months . . . shall inure to and be recoverable by the issuer . . . ." Congress expressly considered and rejected a provision in the original version of the Exchange Act introduced in the Senate that would have provided criminal liability for short-swing trading. S. 2693, 73d Cong., 2d Sess. § 15(b) (1934) ("It shall be unlawful for any director, officer, or [five percent beneficial or record owner] . . . (1) To purchase any . . . security with the intention or expectation of selling the same security within six months; and any profit made by such person on any transaction . . . extending over a period of less than six months shall inure to and be recoverable by the issuer . . . ."). While this Court has suggested that the elimination of criminal liability may have arisen from difficulties of proving the mental elements of the offense, *Foremost-McKesson, Inc. v. Provident Sec. Co.*, 423 U.S. 232, 248 n.23 (1976), it is also consistent with an intention to narrow the enforcement scheme only to those parties who are financially affected by such transactions.

courts, and not with the Commission, the [Commission staff] does not render advice with respect to liability under Section 16(b)."); Ownership Reports and Trading By Officers, Directors and Principal Stockholders, Exchange Act Release No. 34-26333, [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,343, at 89,599 n.21, 42 SEC Docket 464, 467 n.21 (Dec. 2, 1988) ("Unlike other provisions of the Exchange Act, Section 16(b) is enforced by shareholders bringing derivative actions on behalf of the issuer, rather than by the Commission or by shareholders directly pursuing claims for damages."). It would be anomalous for Congress to have intended that a private person no longer having a financial interest in the controversy could maintain a Section 16(b) action when the agency charged generally with enforcement of the securities laws could not itself maintain such an action.

The continuous ownership requirement is also consistent with the approach applied generally in shareholder derivative actions, which provided the model for the enforcement scheme chosen by Congress with respect to Section 16(b). *See, e.g.*, *Rothenberg*, *supra*, at 91,691-92 (Section 16(b)'s continuous ownership requirement analogous to requirement imposed in cases addressing standing to maintain shareholder derivative actions in federal court); *Portnoy*, *supra*, 607 F.2d at 767; *Staffin*, *supra*, 509 F. Supp. at 840. As the court noted in *Portnoy*:

> The underlying rationale of these cases is that because a shareholder will receive at least an indirect benefit (in terms of increased shareholder equity) from any corporate recovery, he has an adequate interest in vigorously litigating the claim. A non-shareholder or one who loses his shareholder interest during the course of the litigation may lose any incentive to pursue the litigation adequately.

607 F.2d at 767.

The continuous ownership requirement is also compelled by constitutional standing requirements under the case or controversy provisions of Article III. As this Court stated in

Gladstone, Realtors v. Village of Bellwood, 441 U.S. 91 (1979), Article III's case or controversy requirement imposes a constitutional limit on Congress's power to grant standing so that "[a] plaintiff must always have suffered 'a distinct and palpable injury to himself' that is likely to be redressed if the requested relief is granted." *Id.* at 100 (quoting *Warth v. Seldin*, 422 U.S. 490, 501 (1975)). Since a security holder bringing a Section 16(b) action need not have been injured by the alleged conduct—indeed, lower courts have not required that Section 16(b) plaintiffs own securities of the issuer at the time of the transactions at issue, *see Blau v. Mission Corp.*, 212 F.2d 77, 79 (2d Cir.), *cert. denied*, 347 U.S. 1016 (1954); *Pellegrino v. Nesbit*, 203 F.2d 463, 466 (9th Cir. 1953)—this constitutional requirement that all parties have a stake in the outcome can only be fulfilled if the plaintiff possesses an investment interest in the issuer the value of which may be enhanced by a recovery.

This constitutional requirement must be met not only at the threshold of the litigation, but throughout the course of the litigation. *See Lewis v. Knutson*, 699 F.2d 230, 236-37 (5th Cir. 1983) (addressing continuous ownership requirement in shareholder derivative litigation: "[T]he constitutional limitation continues to arise when . . . plaintiffs' injury has not fully developed into a claim or has passed."). As the dissent noted below, "Once a plaintiff loses his status as the owner of stock in the issuer, the terminated ownership does not present a case or controversy for the exercise of judicial power . . . . 'The rule in federal cases is that an actual controversy must be extant at all stages . . . , not merely at the time the complaint was filed.' " 909 F.2d at 733; 22a-23a (quoting *Preiser v. Newkirk*, 422 U.S. 395, 401 (1975)).

B. The Court Of Appeals Improperly Ignored The Plain Language Of Section 16(b)'s Standing Provisions

Believing that it was unconstrained by the continuous ownership requirement, the majority below grafted an exception onto the clear words of Section 16(b) to accord standing to former owners of securities of the issuer. In so doing, the

opinion below makes clear the virtual exclusive reliance by the majority on its perception of the "policy behind the statute" in interpreting the language "owner of any security of the issuer" to include a person who is no longer such an owner. 909 F.2d at 729; 12a ("In keeping with the general rules of § 16(b) analysis, the question of whether a plaintiff has standing to bring suit is, in part, determined by whether the policy behind the statute is best served by allowing the claim."). Although the majority noted the principle that "only where differing constructions of § 16(b)'s terms are possible may a court interpret the statute in a way that serves Congress' purpose," *id.* at 728; 9a (citation omitted), it failed entirely to establish what it claimed to be the predicate for its heavy reliance on the policy behind the statute.

The majority's assertion that it was free to consider the policy behind that statute because the relevant language of Section 16(b) allowed alternative constructions, 909 F.2d at 728; 10a (citing *Reliance Elec. Co. v. Emerson Elec. Co.*, 404 U.S. 418, 424 (1972); *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 594 (1973)), is insupportable. The language of Section 16(b) gives no indication whatsoever that a "former" owner of a security of the issuer may maintain an action. Besides issuers[8] themselves, Congress chose to

8 The importance of adherence to the literal meanings of the words of the statute is underscored by comparing the statutory definition of "issuer" under the Exchange Act, Exchange Act § 3(a)(8), 15 U.S.C. § 78c(a)(8), which is limited strictly to the entity that issues the security involved, with Section 2(11) of the Securities Act of 1933, 15 U.S.C. § 77b(11), which includes in the definition of issuer for certain purposes under that Act "any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer." *See Portnoy*, 607 F.2d at 767-68 (rejecting plaintiff's request to broaden definition of "issuer" for purposes of Section 16(b) to include parent of issuer: "Congress has spoken clearly. When it wanted a broader definition of issuer, it drafted one."). *Cf. Blau v. Lehman*, 368 U.S. 403, 409-13 (1962) (rejecting broad definition of term "director" under statute as including a partnership of which a director is a partner). The majority below disclaimed any reliance on a broad definition of "issuer" as the basis for Respondent's standing, *see* 909 F.2d at 729; 13a, relying instead on a broad definition of "owner."

provide Section 16(b) standing only to those who are "the owner[s] of any security of the issuer"—a provision that cannot reasonably be read to include "a person who is not now an owner but once was the owner of any security of the issuer."

The majority turned the straightforward statutory language on its head by asserting that, since Congress did not insert the word "current" before the word "owner" in the statute, "former" owners may sue if the court determines that permitting such a suit would advance the remedial purpose of the statute. 909 F.2d at 730; 15a. It must be presumed, however, that when Congress imposes as a condition to standing to bring a lawsuit the requirement that the plaintiff have a specified status, it intends to require that the plaintiff have that status currently, rather than in the past. The use of the qualifier "current" would add nothing.

Contrary to the reasoning of the court below, if Congress had for any reason intended to broaden the standing requirements of Section 16(b) to include former owners, it could easily have done so. *Lewis v. McAdam*, 762 F.2d 800, 803 (9th Cir. 1985) (per curiam). But Congress authorized only "owners"—not "owners or former owners"—to bring suit under Section 16(b). Nor is there anything in the legislative history remotely indicating that Congress intended such an illogical reading of the word "owner." *See id.* at 804 ("We find nothing in the legislative history of section 16(b) indicating that the plain meaning of the statutory language is inadequate to effect the congressional purpose of providing an enforcement mechanism against insider trading."); dissenting opinion below, 909 F.2d at 735-36; 28a. As this Court has admonished, "congressional silence . . . cannot override the words of the statute." *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 495-96 n.13 (1985).

Under the plain meaning of Section 16(b), only an existing owner of a security of the issuer has standing to commence and maintain such an action. Whatever the merits or demerits of the statute's failure to extend standing to "former" own-

ers of such a security, this limitation "is inherent in the statute as written, and its correction must lie with Congress," not with the courts. *Id.* at 499. As this Court noted in *Blau v. Lehman*, 368 U.S. 403, 413 (1962), in which the Court rejected a prior invitation by the Commission to judicially rewrite Section 16(b)'s scope, "Congress is the proper agency to change an interpretation of the [Exchange] Act unbroken since its passage, if the change is to be made." *See also TVA v. Hill*, 437 U.S. 153, 194 (1978) ("Our individual appraisal of the wisdom or unwisdom of a particular course consciously selected by the Congress is to be put aside in the process of interpreting a statute."); *Lewis, supra*, 762 F.2d at 804 ("We have no constitutional authority to rewrite a statute simply because we may determine that it is susceptible of improvement.") (citing *Badaracco v. Commissioner*, 464 U.S. 386 (1984)); *Untermeyer v. Valhi*, 665 F. Supp. 297, 300 (S.D.N.Y. 1987) ("[T]he statutory language may not be strained or distorted to add to the 'prophylactic' effect Congress itself clearly prescribed in § 16(b)."), *aff'd mem.*, 841 F.2d 1117 (2d Cir.), *aff'd on reh'g*, 841 F.2d 25 (2d Cir.), *cert. denied*, 488 U.S. 868 (1988). As the dissent below concluded:

> The statute unambiguously states that "the owner of any security of the issuer" may sue to recover short-swing profits that are recoverable by the issuer under § 16(b). There is simply no indication in any of the legislative history of § 16(b) that the plain meaning of the words "owner of any security of the issuer" was meant to include or even could include one who is no longer the owner of any security of the issuer. Nor is there anything in the legislative history from which to believe "that the plain meaning of the statutory language is inadequate to effect the congressional purpose of providing an enforcement mechanism against insider trading. That a merger may result in a corporation succeeding to an action formerly held by an individual is a consequence dictated by the statute." *Lewis*, 762 F.2d at 804. Certainly, Congress has had ample opportunity to amend § 16(b) had it so desired.

909 F.2d at 735-36; 28a-29a (footnote omitted).

C. The Court Of Appeals' Reliance On Perceived Policy In Expanding Upon The Language Of Section 16(b) Contradicts This Court's Long-Established Section 16(b) Jurisprudence

Section 16(b) is unique among the express civil liability provisions of the Securities Act of 1933 (the "Securities Act") and the Exchange Act. While every other express civil liability provision in the Securities Act or Exchange Act "contains a state-of-mind condition requiring something more than negligence," *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 209 n.28 (1976), Section 16(b) is, by its terms, a strict liability statute, imposing liability "irrespective of any intention on the part of [the] beneficial owner, director, or officer," Exchange Act § 16(b), 15 U.S.C. § 78p(b). Section 16(b)'s unique standing requirements are consistent with this strict liability approach: it is the only express civil liability provision in the Securities Act or Exchange Act that does not limit standing to persons who purchase or sell securities in connection with the alleged violation.[9] *Cf. Blue Chip Stamps*

9 *See* Section 11(a) of the Securities Act, 15 U.S.C. § 77k(a) (liability for material misstatements or omissions in a registration statement; right of action provided for "any person acquiring [a] security"); Section 12 of the Securities Act, 15 U.S.C. § 77*l* (liability for offers or sales of securities in violation of prospectus delivery requirements or by means of prospectus or oral communications that include material misstatements or omissions; right of action for "the person purchasing such security from" the defendant); Section 9(e) of the Exchange Act, 15 U.S.C. § 78i(e) (liability for certain fraudulent and manipulative practices; right of action for "any person who shall purchase or sell any security at a price which was affected by such act or transaction"); Section 18(a) of the Exchange Act, 15 U.S.C. § 78r(a) (liability for false or misleading statements contained in certain documents filed with the Commission; right of action for "any person . . . who . . . shall have purchased or sold a security at a price which was affected by such statement"); Section 20A(a) of the Exchange Act, 15 U.S.C.

v. Manor Drug Stores, 421 U.S. 723, 734 (1975) (citing Section 16(b) in support of the proposition that "[w]hen Congress wished to provide a remedy to those who neither purchase nor sell securities, it had little trouble in doing so expressly."). Indeed, as the lower courts have interpreted Section 16(b), a plaintiff need not have owned securities of the issuer at the time of the transactions at issue, and may purchase securities for the very purpose of bringing suit. *See Blau v. Mission Corp.*, 212 F.2d 77, 79 (2d Cir.), *cert. denied*, 347 U.S. 1016 (1954); *Pellegrino v. Nesbit*, 203 F.2d 463, 466 (9th Cir. 1953).

Partly in recognition of the broad sweep of Section 16(b), this Court has consistently required that its provisions be interpreted narrowly. Indeed, in every decision by this Court interpreting Section 16(b), this Court has rejected any proposed expansive interpretation of the statute.[10] In *Foremost-*

§ 78t-1(a) (liability for insider trading; right of action to "any person who, contemporaneously with the purchase or sale of securities that is the subject of such violation, has purchased . . . or sold . . . securities of the same class"). In addition, Section 29(b) of the Exchange Act, 15 U.S.C. § 78cc(b), provides a right of action to declare certain contracts made in violation of the Exchange Act void. Although the statute does not set forth an express standing requirement for all actions brought under it, it does provide an express limitations period for certain actions brought "by any person to or for whom any broker or dealer sells, or from or for whom any broker or dealer purchases, a security."

10 *Foremost-McKesson, Inc. v. Provident Sec. Co.*, 423 U.S. 232 (1976) (defendant must be 10% beneficial owner before purchase of securities is subject to Section 16(b); not sufficient that purchase of securities causes defendant to become 10% beneficial owner); *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973) (binding option for defeated tender offeror to sell post-merger securities not deemed a "sale" under Section 16(b) because potential for abuse not present); *Reliance Elec. Co. v. Emerson Elec. Co.*, 404 U.S. 418 (1972) (Section 16(b) applies only to sales occurring while defendant is 10% beneficial owner; sales occurring after defendant had reduced ownership to 9.96% outside scope of statute); *Blau v. Lehman*, 368 U.S. 403 (1962) (partnership of which director in issuer corporation was a partner could not be held liable under Section 16(b) for profits earned by it in short-swing transactions).

McKesson, Inc. v. Provident Sec. Co., 423 U.S. 232, 251 (1976), this Court noted that Section 16(b) "imposes liability without fault within its narrowly drawn limits." The Court went on to say that "[i]t is inappropriate to reach the harsh result of imposing § 16(b)'s liability without fault on the basis of unclear language. If Congress wishes to impose such liability, we must assume it will do so expressly or by unmistakable inference." *Id.* at 252; *see also Reliance Elec. Co. v. Emerson Elec. Co.*, 404 U.S. 418, 427 (1972) ("[W]e are not free to adopt a construction that not only strains, but flatly contradicts, the words of the statute."). As this Court has previously emphasized, because Section 16(b) imposes a standard of strict liability, it is generally applied with a "mechanical quality." *Reliance Elec.*, *supra*, 404 U.S. at 425.[11]

In ignoring the plain, unambiguous language of the statute, the majority below not only disregarded, but flatly contradicted, the clear mandate of this Court not to construe Section 16(b) expansively even when the language is unclear. Indeed, the majority's statement that "[w]hen the statute permits interpretation the section traditionally has been read broadly in view of its remedial purposes," 909 F.2d at 728; 10a, stands on its head this Court's statement in *Foremost-McKesson* that ambiguities are to be resolved against liability.

Moreover, in the two decisions of this Court cited by the majority below as authority for its heavy reliance on the perceived policy underlying the statute, *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973), and *Reliance Elec.*, *supra*, *see* 909 F.2d at 727-28; 8a-10a, as well as in every other decision of this Court addressing Section 16(b) (*see* note 10, *supra*), this Court actually declined to apply an expansive reading of Section 16(b). As this Court

11 This Court has also rebuffed efforts to expand categories of persons entitled to standing under the securities laws. *See, e.g.*, *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975) (only purchaser or seller may bring implied action under Exchange Act § 10(b), 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5); *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1 (1977) (unsuccessful tender offeror has no standing to sue under Exchange Act § 14(e), 15 U.S.C. § 78n(e)).

noted in *Foremost-McKesson*, *supra*, 423 U.S. at 252, "[i]n neither [*Kern County Land Co.* nor *Reliance Elec.*] did the Court adopt the construction that would have imposed liability, thus recognizing that serving the congressional purpose does not require resolving every ambiguity in favor of liability under § 16(b)."

The weakness of the majority's analysis in relying on perceived policy over the plain language of the statute is highlighted by the inconsistency with which it applies that analysis. In an effort to avoid the effect of prior decisions of other circuits, and of the Second Circuit itself, which held that shareholders who lost their shares in a merger involving the issuer did not have standing under Section 16(b), *see Portnoy v. Kawecki Berylco Indus., Inc.*, 607 F.2d 765, 767-68 (7th Cir. 1979); *Rothenberg v. United Brands Co.*, [1977-78 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,045 (S.D.N.Y. May 11, 1977), *aff'd mem.*, 573 F.2d 1295 (2d Cir. 1977), the majority sought to limit its expansion of the standing requirement to "a novel situation where former shareholders have a continuing interest in maintaining suit in behalf of the issuer." 909 F.2d at 730-31; 16a-17a. This arbitrary, piecemeal expansion of the statute to provide standing to some, but not all, former holders of securities of the issuer (only those who had exchanged their shares for securities in the acquiror of the issuer) completely undercuts the majority's interpretation of the language of the statute as not limited to "current" security holders. If the language of the statute were in fact susceptible of being interpreted as granting standing to those who formerly held securities of the issuer, there is no principled textual basis for distinguishing between those who were cashed out in a merger and those who received, in exchange for their securities in the issuer, securities of the issuer's acquiror. Indeed, nothing would prevent a shareholder who was cashed out in a merger with another public corporation from reinvesting the cash in securities of the acquiror and then renewing his suit—or commencing a new action—to recover under Section 16(b) on behalf of the newly acquired subsidiary. Yet the opinion of

the majority below suggests that such a suit would not be allowed, while a shareholder who received his shares in the acquiring corporation in the acquisition itself could continue his suit. 909 F.2d at 730-71; 16a-17a. This distinction is without any substance and cannot be supported by the language of the statute or by any perceived reason of policy.

The self-contradictory approach of the majority below demonstrates the dangers of embarking on inquiries into perceived policies behind statutes where such inquiries are not justified or compelled by the statutory language—especially where Section 16(b) is concerned. By relying on what it perceived as the sole policy behind Section 16(b) of preventing insider trading, the majority ignored Congress's clear countervailing policy—manifest in the language of the standing provisions of the statute itself—of providing standing for this strict liability statute only to a narrowly, and clearly, defined group of parties. *See Foremost-McKesson*, *supra*, 423 U.S. at 252 ("It is not irrelevant that Congress itself limited carefully the liability imposed by § 16(b).").

The difficulties, and arbitrariness, involved in the essentially legislative task of drawing lines based on perceived policy in this area is also highlighted by the Commission's recent tortured efforts to propose rules that would create exceptions to Section 16(b)'s standing requirements. In its initial proposed Section 16 rule changes announced in 1988, the Commission proposed a rule that would have defined the term "owner of any security of the issuer" for purposes of Section 16 as:

> a beneficial owner of securities of the issuer at the time of suit or, if as a result of a business combination the issuer, at the time of suit, does not have a reporting obligation under Section 13 or 15(d) of the Act with respect to an equity security, a former beneficial owner of the issuer who was required to surrender such securities due to such business combination.

Ownership Reports and Trading By Officers, Directors and Principal Stockholders, Exchange Act Release No. 34-26333,

42 SEC Docket 464, 503 (Dec. 2, 1988) (proposed Rule 16a-1(h)). The Commission sought to justify this proposed rule—which, in according standing to any former security holder who lost his securities in a merger, whether before or after the suit began, would abrogate not only the continuous ownership requirement, but even the requirement of ownership at the commencement of the suit—on the ground that existing law "undercuts the policing function played by shareholders in Section 16(b) actions." *Id.*, [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,343, at 89,620, 42 SEC Docket at 490.

When the Commission's Section 16 rule changes were reproposed in 1989, the scope of this rule was narrowed considerably in response to public comment so that the term "owner of any security of the issuer" for purposes of Section 16 would be defined as:

> a beneficial owner of securities of the issuer at the time of filing a lawsuit under Section 16(b) of the Act. If as a result of a business combination of the issuer, a beneficial owner of any security of the issuer is required to surrender the securities due to such business combination, such person shall continue to be deemed a beneficial owner until resolution of the lawsuit if the suit was filed prior to the surrender of securities.

Ownership Reports and Trading By Officers, Directors and Principal Stockholders, Exchange Act Release No. 34-27148, 44 SEC Docket 526, 553 (Aug. 18, 1989) (reproposed Rule 16a-1(g)). This change preserved the requirement of ownership of securities at the commencement of the suit, but adopted an exception to the continuous ownership requirement for mergers. Apparently uncomfortable, however, with the new lines it had drawn, the Commission solicited comment as to whether the rule should also permit former shareholders to sue within a specified period after losing their shares in a merger or if they had made a statutory demand on the issuer within a specified period prior to a merger (once again diluting the requirement of ownership at the commencement of the suit), or whether it should require that the plaintiff own securities of the surviving company "[t]o ensure that the plaintiff has a sufficient financial interest in the outcome to warrant an extension of standing."[12] *Id.*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,439, at 80,397, 44 SEC Docket at 544.

In formally announcing its final comprehensive rule changes under Section 16 on February 8, 1991, the Commission withdrew from its effort to adopt standing requirements pursuant to its rulemaking authority[13] pending this Court's decision in this case. *See* Ownership Reports and Trading By Officers, Directors and Principal Stockholders, Exchange Act Release No. 34-28869, at 87-88 (Feb. 8, 1991). Given the Commission's failure over a two-year period to arrive at satisfactory exceptions to the requirement of ownership at the commencement of the suit and the continuous ownership requirement—indeed, even to articulate a coherent policy for drawing such lines—it is clear that if there are to be any such exceptions, they should be established legislatively and not by the judiciary.[14]

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12 Significantly, this suggested modification, which would incorporate the financial interest principle underlying Section 16(b)'s standing provisions, would reflect existing law. *See, e.g.*, *Newmark v. RKO General, Inc.*, 425 F.2d 348, 352 n.4 (2d Cir.) (plaintiff security holder of company surviving merger has standing to bring Section 16(b) suit based on pre-merger trading in shares of issuer, which did not survive merger), *cert. denied*, 400 U.S. 854 (1970). Because International was the surviving company in its merger with a subsidiary of Viacom, and because the Respondent did not own securities of International, he would not have had standing if the Commission's suggested modification were incorporated into the rule.

13 The Commission's authority to promulgate for the federal judiciary rules governing the standing of a private plaintiff to maintain an action would appear to be doubtful in any event, but this need not now be resolved since the Commission has withdrawn its proposed rule.

14 The majority opinion below cited the Commission's views, including the proposed rules under Section 16(b), in support of its result, although it acknowledged that "the proposed rule is inapplicable in the case at hand." 909 F.2d at 730; 14a (citing *Mayer v. Chesapeake Ins.*

D. Adherence To The Clear Language Of Section 16(b) Will Not Undercut Enforcement Of The Statute

The majority below sought to buttress its departure from the language of Section 16(b) by asserting that the reorganization of International as a wholly owned subsidiary of Viacom presented a "danger of . . . intentional restructuring to defeat the enforcement mechanism incorporated in the statute." 909 F.2d at 731; 17a. This contention is incorrect both as a factual matter in this case and as a policy matter generally.

The record unequivocally shows that the merger was a bona fide transaction with a valid business purpose—facilitating the acquisition of International by National Amusements, a previously unrelated party. The merger was the culmination of an "auction" process by which National Amusements competed with a group led by senior management of International in making a series of bids for the company beginning in September 1986—four months before this action was brought and one month before the transactions allegedly underlying Respondent's claim. Moreover, the transaction was not an "involuntary" one, as suggested by

Co., 877 F.2d 1154, 1162 (2d Cir. 1989), *cert. denied*, 110 S. Ct. 722 (1990)). In light of the Commission's lack of enforcement authority under Section 16(b), however, *see* Part A, *supra*, the Court of Appeals' deference to the views of the Commission was misplaced. *Cf. Ford Motor Credit Co. v. Milhollin*, 444 U.S. 555, 565 (1980) (deference is to be given "to the views of the administrative entity appointed *to apply and enforce a statute*") (emphasis added). Moreover, the Commission's recent, waffling attempt at rulemaking in this area, described above, hardly constitutes the kind of "binding, consistent, official interpretations of its statute over a long period of time" that would justify the invocation of the "administrative deference" rule. *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1, 41 n.27 (1977). Moreover, as the dissent noted below, " '[the Commission's] presumed "expertise" in the securities-law field is of limited value when the narrow legal issue is one peculiarly reserved for judicial resolution, namely whether a cause of action should be implied by judicial interpretation in favor of a particular class of litigants.' " 909 F.2d at 734 n.2; 24a (quoting *Piper v. Chris-Craft Indus., Inc.*, *supra*, 430 U.S. at 41 n.27).

the majority opinion below. 909 F.2d at 731; 17a. Rather, it was a consensual merger that was required to be, and was, approved by the holders of a majority of International common stock, over 80 percent of which was held by shareholders who were independent of National Amusements or its affiliates. In short, the record overwhelmingly demonstrates that the transaction was not in any way related to this lawsuit, and could not possibly have been undertaken for the purpose of "defeat[ing] the enforcement mechanism incorporated in the statute."[15] *See* dissenting opinion below, 909 F.2d at 732; 20a (merger had a valid business purpose).

To the extent the statement of the majority below reflected a policy concern that denial of standing in merger situations would "defeat the enforcement mechanism incorporated in the statute," it is also completely unfounded. The enforcement mechanism chosen by Congress—suit by the issuer or the owner of a security of the issuer—remains unimpeded, since both of these parties (in this case, International and Viacom) are completely free to pursue any valid pre-merger Section 16(b) claim. The fact that those parties have chosen not to pursue the claim does not justify permitting a former stockholder of the issuer to do so.

Similarly, there is no empirical basis for the assertion of the majority below that "[a]s a practical matter it is unrealistic to believe that the issuing corporation will bring an action against itself or its insiders." 909 F.2d at 729; 13a. A Section 16(b) "insider" may well be a person who is not in fact an "insider," including one who purchases more than ten percent of the stock of the corporation without the consent, or even in defiance, of its management. Particularly in merger transactions—which are frequently preceded by unsolicited

15 In addition, dissenting shareholders were entitled to elect to receive the "fair cash value" of their shares, Proxy Statement at 16; JA 25-JA 26, which could include the shareholders' pro-rata portion of any Section 16(b) claims held by the company, *see Portnoy*, *supra*, 607 F.2d at 770 n.2 (dissenting opinion) (shareholder appraisal rights in connection with merger may take into account " 'a *pro rata* portion of any possible Section 16(b) claim' ") (quoting from proxy statement).

purchases of stock—the issuer, or its new parent, will often have no reason to avoid bringing a Section 16(b) action against the former ten percent shareholder.[16] *See Bunker Ramo-Eltra Corp. v. Fairchild Indus., Inc.*, 639 F. Supp. 409, 415 (D. Md.) ("Most of the section 16(b) violation cases involving hostile takeover situations, were brought by or on behalf of the successor by merger to the original issuer."), *appeal dismissed*, 801 F.2d 393 (4th Cir. 1986). Indeed, this Court's decisions in *Kern County Land Co.* and *Reliance Elec.* both involved suits by post-takeover issuers (*not* security holders) against former ten percent beneficial owners who had made failed takeover attempts.

In the unlikely situation in which a publicly held corporation is merged with another entity for the sole purpose of depriving a security holder of standing to maintain a Section 16(b) action, the plaintiff may prevent the merger, and preserve his standing, by seeking to have the merger enjoined or annulled, *see, e.g., Heit v. Tenneco, Inc.*, 319 F. Supp. 884, 885-86 (D. Del. 1970) (plaintiff lost standing to maintain derivative suit after merger; appropriate remedy was to apply for an injunction prior to merger), or pursue an action against the corporation's directors for breach of fiduciary duty, *see, e.g., Merritt v. Colonial Foods, Inc.*, 505 A.2d 757 (Del. Ch. 1986) (cash-out merger for purpose of terminating plaintiffs' standing to maintain pending derivative litigation against corporate insiders constituted breach of fiduciary duty of directors and controlling shareholders); *Untermeyer v. Valhi*, 665 F. Supp. 297, 300 (S.D.N.Y. 1987) (if new ultimate parent company of issuer, CSX, were improperly

16 Any agreement that the former "insiders" might have negotiated prior to the acquisition obligating the issuer or its new owner not to bring a Section 16(b) action would be unenforceable under Exchange Act § 29(a), 15 U.S.C. § 78cc(a), which renders void "[a]ny condition, stipulation, or provision binding any person to waive compliance with any provision of [the Exchange Act] or of any rule or regulation thereunder." *See, e.g., Allied Artists Pictures Corp. v. Giroux*, 312 F. Supp. 450, 451 (S.D.N.Y. 1970); *Bunker Ramo-Eltra Corp. v. Fairchild Indus., Inc.*, 639 F. Supp. 409, 418-19 (D. Md.), *appeal dismissed*, 801 F.2d 393 (4th Cir. 1986).

deterred from bringing Section 16(b) action, shareholders of CSX "are not without a remedy. They could bring a derivative suit against the directors and officers of CSX for breach of fiduciary duty . . . ."), *aff'd mem.*, 841 F.2d 1117 (2d Cir.), *aff'd on reh'g*, 841 F.2d 25 (2d Cir.), *cert. denied*, 488 U.S. 868 (1988).

Moreover, in those cases where actual abuse of inside information can be shown—and there has been no allegation by Respondent or any indication in the record that this occurred here—the securities laws provide other sanctions. In this regard, this Court's reasoning in *Foremost-McKesson, supra*, where the Court held that a defendant must be a ten percent beneficial owner before purchases and sales of securities would be subject to Section 16(b) (thus excluding the transaction that causes the defendant to exceed the ten percent threshold), is particularly appropriate:

> Congress . . . has left some problems of the abuse of inside information to other remedies. These sanctions alleviate concern that ordinary investors are unprotected against actual abuses of inside information in transactions not covered by § 16(b).

423 U.S. at 255. The Court in *Foremost-McKesson* then cited Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a), and Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5, as examples of provisions that afforded the Commission and injured investors a remedy for abuse of inside information. 423 U.S. at 255. Since *Foremost-McKesson* was decided in 1976, Congress has further added to the arsenal of remedies available against abuse of inside information with the Insider Trading Sanctions Act of 1984, Exchange Act § 21A, 15 U.S.C. § 78u-1, which permits the Commission to seek a penalty against insider trading of up to three times the profits gained, and the Insider Trading and Securities Fraud Enforcement Act of 1988, Exchange Act § 20A, 15 U.S.C. § 78t-1, which provides a private right of action for insider trading to anyone who purchases or sells securities contemporaneously with

the alleged violation. Thus, the reasoning of this Court in *Foremost-McKesson* applies even more strongly today, and the Court of Appeals' expansion of the standing requirements of Section 16(b) is particularly inappropriate in light of that reasoning.

E. This Case Is Not Properly Distinguishable From Other Section 16(b) Standing Cases

Despite the efforts of the majority below to avoid a conflict with prior decisions by seeking to distinguish those decisions factually, its ruling that "owner of any security of the issuer" also means "former" owner of any security of the issuer is squarely at odds with rulings of the Seventh and Ninth Circuits—the only other Courts of Appeals that have addressed the issue—as well as with prior case law of the Second Circuit itself. These prior decisions confirmed that the plain meaning of "owner of any security of the issuer"—as set forth in Part B, *supra*—confers standing only on one who continues to be an owner of the issuer's securities throughout the lawsuit.

In *Portnoy v. Kawecki Berylco Indus., Inc.*, 607 F.2d 765 (7th Cir. 1979), a case that is virtually indistinguishable from the instant case, the plaintiff commenced a Section 16(b) action to recover profits from short-swing trading in shares of KBI. At the time the action was commenced, the plaintiff was a shareholder in KBI as well as another corporation (Cabot). Five days after the commencement of the action, KBI entered into a merger transaction in which shareholders of KBI were cashed out and as a result of which KBI became the wholly owned subsidiary of CSMC, which in turn was a subsidiary of Cabot. The plaintiff then amended his complaint to assert that he was maintaining it on behalf of Cabot as well as KBI.

The Seventh Circuit was faced with two questions: Was the plaintiff still an "owner of any security of the issuer" (KBI) within the meaning of Section 16(b)? And did the plaintiff's status as a shareholder of Cabot give him standing under Section 16(b)? The court answered both questions in the negative.

As for the plaintiff's status as an "owner of any security of the issuer," the court ruled that once the plaintiff lost his shares of KBI, he lost his standing to sue on its behalf under Section 16(b). *Portnoy*, 607 F.2d at 767 (citing *Rothenberg v. United Brands Co.*, [1977-78 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,045 (S.D.N.Y. May 11, 1977), *aff'd mem.*, 573 F.2d 1295 (2d Cir. 1977)).

On the second question, whether owning a security of the grandparent of the issuer was sufficient to confer Section 16(b) standing, the court noted that the policy grounds urged to permit such standing did not permit it to "rewrite the statute to accommodate this situation [since] Congress has spoken clearly." 607 F.2d at 768. The court noted that, as is true in this proceeding, the issuer still existed and its sole shareholder (there CSMC, here Viacom) "had the right to bring the action regardless of whether it chose to exercise that right." *Id.* at 769. In a passage that could easily have been directed at the reasoning of the Court of Appeals below, the Seventh Circuit further noted that "[i]t would be a dangerous precedent to confer standing on a plaintiff who falls outside the class of parties permitted by the language of the statute to bring suit merely because the only parties that fall within the class choose not to exercise their right to sue."[17] *Id.* Accordingly, the court ruled that the plaintiff lacked standing.

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17 The court also noted that, although the result in *Portnoy* may appear to be "a harsh one in that a possible violation will apparently go uncorrected, we note on the more positive side that the plaintiff has not argued that the merger which cut off his standing . . . was accomplished for the fraudulent purpose of avoiding enforcement of the § 16(b) claim." *Id.* Similarly, as discussed in Part D, *supra*, Respondent has never contended in this case that the acquisition of International by Viacom was undertaken for the purpose of avoiding enforcement of Section 16(b), and the record amply demonstrates that the merger was unrelated to this lawsuit.

The Ninth Circuit, in a decision by a panel that included Justice (then Judge) Kennedy, reached a similar result in *Lewis v. McAdam*, 762 F.2d 800 (9th Cir. 1985) (per curiam). There, Coldwell Banker was acquired by Sears through a wholly owned subsidiary of Sears, SDC. Thereafter Coldwell Banker ceased to exist as a separate corporate entity. The plaintiff who commenced this Section 16(b) action was a shareholder of Sears, and had never owned stock of Coldwell Banker or SDC. He sought the recovery of short-swing profits made by a director of Coldwell Banker through the director's sale of his Coldwell Banker shares.

In determining whether the plaintiff had standing, the *Lewis* court concluded that the answer was readily ascertained from the language of the statute:

> Section 16(b) permits a security holder of the issuer to bring a section 16(b) action only after the issuer has failed either to institute an action or to prosecute diligently after instituting an action. We find nothing in the legislative history of section 16(b) indicating that the plain meaning of the statutory language is inadequate to effect the congressional purpose of providing an enforcement mechanism against insider trading. That a merger may result in a corporation succeeding to an action formerly held by an individual is a consequence dictated by the statute. We will not confer standing on a plaintiff who falls outside the class of persons permitted by the language of the statute to bring suit merely because the only parties falling within the class choose not to exercise their right to sue. *Portnoy*, 607 F.2d at 769.
>
> Congress is well aware of the corporate practice of parent companies utilizing wholly owned subsidiaries in merger transactions. Had Congress wanted to discourage this practice by conferring standing on shareholders of a parent corporation whose wholly owned subsidiary absorbed the original issuing corporation, it knew how to do so.

762 F.2d at 804. Accordingly, the *Lewis* court concluded that the plaintiff lacked standing. *See also Staffin v. Greenberg*, 509 F. Supp. 825, 840 (E.D. Pa. 1981) ("[T]he law requires that to maintain a derivative action under section 16(b) a plaintiff must have and maintain his standing as a shareholder at the commencement of the law suit and throughout the litigation.") (citing *Portnoy*, *supra*, and *Rothenberg*, *supra*), *aff'd on other grounds*, 672 F.2d 1196 (3d Cir. 1982).

Prior to the holding of the Court of Appeals below, it had also been the law in the Second Circuit that a plaintiff security holder who commenced a Section 16(b) suit on behalf of an issuer had to own and continue to own his securities of the issuer throughout the litigation, and that if such a plaintiff ceased to own such securities—for any reason—he was denied standing to continue the action.[18] For example, in

18 The only exception to this rule was the district court decision in *Blau v. Oppenheim*, 250 F. Supp. 881 (S.D.N.Y. 1966). In *Blau*, the court held that a shareholder of American Can Company could bring a Section 16(b) suit against a former director of a company which had sold all its assets to a subsidiary of American Can and thereafter ceased to exist. In sustaining the plaintiff's standing in *Blau*, the court noted that the original issuer had ceased to exist as a corporate entity after the transaction and thus it no longer had any shareholders who could sue. It concluded that to limit standing to the former shareholders of the now defunct issuer would mean that no one could possibly bring a Section 16(b) suit against the company's former directors. In so holding, the court, like the majority below, relied almost exclusively on the perceived policy behind the statute, virtually ignoring the language. *Id.* at 887 ("In sum, the essential argument which the defendant advances is one of language. But language alone can never be dispositive of a statute's meaning."). Other courts have criticized *Blau's* reasoning. *See, e.g., Portnoy*, 607 F.2d at 769 n.8; *Lewis*, 762 F.2d at 803-04; dissenting opinion below, 909 F.2d at 734; 24a-26a. *Blau* is inapplicable to the instant case in any event because the issuer, International, survived the merger and remains a viable corporation as a wholly owned subsidiary of Viacom.

Prior to the decision below, *Blau* had been distinguished in the Second Circuit on the ground that the issuer in that case was no longer a viable corporate entity. *See Untermeyer v. Valhi, Inc.*, 665 F. Supp. 297, 300 (S.D.N.Y. 1987), *aff'd mem.*, 84 F.2d 1117 (2d Cir.), *aff'd on reh'g*, 841 F.2d 25 (2d Cir.), *cert. denied*, 488 U.S. 868 (1988). Although the majority below referred repeatedly to *Blau* with

Rothenberg v. United Brands Co., [1977-78 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,045 (S.D.N.Y. May 11, 1977), *aff'd mem.*, 573 F.2d 1295 (2d Cir. 1977), the district court held, and the Second Circuit affirmed, that a shareholder who had commenced a Section 16(b) suit lost his standing to continue that suit when he ceased to be a shareholder of the issuer as a result of a "short form" merger (in which public shareholders, including the plaintiff, had no vote) following a tender offer that the plaintiff had refused to accept.[19]

Finally, in *Untermeyer v. Valhi, Inc.*, 665 F. Supp. 297 (S.D.N.Y. 1987), *aff'd mem.*, 84 F.2d 1117 (2d Cir.), *aff'd on reh'g*, 841 F.2d 25 (2d Cir.), *cert. denied*, 488 U.S. 868 (1988), the issuer (Sea-Land) was merged with another corporate entity such that Sea-Land survived and became the wholly owned subsidiary of CSX. In dismissing the plaintiff's Section 16(b) action—on the ground that the plaintiff, an owner of CSX stock, lacked standing because he was not the owner of any security in the issuer, Sea-Land—the district court identified the only parties that would have standing to pursue such an action: the issuer (Sea-Land) or its sole shareholder (CSX). In affirming the district court's decision, the Second Circuit also identified these parties as the only entities that would be entitled to maintain a Section 16(b) action.

approval, the majority's "rule"—extending standing only to "a novel situation where former shareholders have a continuing interest in maintaining suit in behalf of the issuer," 909 F.2d at 730-31; 16a-17a—is actually inconsistent with *Blau*, where the plaintiff had never owned a security of the issuer.

19 The majority below "caution[ed] against an overbroad application of *Rothenberg*" in part on the ground that its "standing analysis was premised on an analogous application of Rule 23.1 which . . . does not govern shareholders bringing § 16(b) claims." 909 F.2d at 730; 16a. However, the *Rothenberg* court was well aware of the distinctions between Section16(b) claims and Rule 23.1, *see Rothenberg* at 91,692, and the majority's opinion below even cited *Rothenberg* in a discussion of the distinctions between Section16(b) claims and Rule 23.1. 909 F.2d at 728; 11a.

Neither court included in the list "former" shareholders of Sea-Land.

The decision of the Court of Appeals below thus plainly stands out in stark contrast to this well-established line of decisions of the Second, Seventh and Ninth Circuits in its willingness to expand the standing provisions of Section 16(b). Indeed, even the Commission, which filed an *amicus* brief in the Court of Appeals below in support of Respondent, has recognized—in releases issued in connection with the proposal of the recently adopted rule changes under Section 16—that it was settled law prior to the Court of Appeals' decision in this case that Section 16(b) plaintiffs must hold their securities of the issuer throughout the course of the litigation. *See, e.g.*, Ownership Reports and Trading By Officers, Directors and Principal Stockholders, Exchange Act Release No. 34-26333, [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,343, at 89,620-21, 42 SEC Docket 464, 490 (Dec. 2, 1988).

In an effort to characterize its decision as not conflicting with these established precedents from its own and other circuits, the majority below identified certain distinctions that purport to set the instant action apart from decisions discussed above.

The sole distinction the majority found in this proceeding from *Portnoy* and *Rothenberg* is that in those cases, the holders of the issuer's securities received only cash for their securities whereas in the instant action, Respondent received cash *and* some stock in the acquiror. The majority maintained that here, unlike in *Portnoy* and *Rothenberg*, Respondent—by virtue of receiving stock in the acquiror—"continues to have at least an indirect financial interest in the outcome of this lawsuit." 909 F.2d at 730; 16a. As for *Lewis* and *Untermeyer*, the majority noted as the sole distinction the fact that in those actions, the plaintiff never held stock in the issuer, but only in the parent corporation. *Id.* at 730; 15a-16a. These distinctions, however, lack substance.

As an initial matter, the majority did not explain why the statutory analysis followed in these cases is not applicable to this proceeding. As set forth above, the Seventh and Ninth Circuit Courts of Appeals have found the language of Section 16(b) at issue to be plain and unambiguous. As noted in Part B, *supra*, statutory language, if clear and unambiguous, will ordinarily be regarded as conclusive, "since it is generally assumed that Congress expresses its purpose through the ordinary meaning of the words it uses." *Lewis, supra*, 762 F.2d at 804 (citing *Escondido Mut. Water Co. v. La Jolla Band of Missions Indians*, 466 U.S. 765, 772 (1984); *North Dakota v. United States*, 460 U.S. 300, 312 (1983); *Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980)). Similarly, the Court of Appeals failed to address the rejection in these prior decisions of the same "policy arguments" that appear to be the sole foundation for the result reached below.

More importantly, the distinctions drawn by the majority prove to be meaningless. First, the majority does not appear to disagree with the general rule that one who owns securities *only* in the parent of the issuer does not have standing under Section 16(b). *See* 909 F.2d at 730; 15a-16a (discussing *Untermeyer* and *Lewis*). The majority opinion, however, seeks to create an exception to this rule for a plaintiff whose securities of the issuer were exchanged for securities in the parent corporation in a merger transaction, thus giving the plaintiff "a continuing interest in maintaining suit in behalf of the issuer." *Id.* at 731; 16a-17a.

The majority's purported distinction wholly fails to explain the opposite result that was reached in *Portnoy*. The plaintiff in *Portnoy* owned securities of the grandparent corporation of the issuer at the time of the merger, and therefore had a "continuing financial interest in the litigation" in every sense that Respondent did here. The majority's implied distinction on the ground that Respondent received his shares in the issuer's parent *in exchange for* his shares of the issuer, while in *Portnoy* the plaintiff's ownership of shares in the issuer's grandparent was independent of the merger, is irrelevant both

to the statutory language and to the majority's perception of the statutory design.

There is no support in the language of the statute, the legislative history or prior case law for distinguishing between a plaintiff who received securities of a parent *directly* in exchange for his securities in the issuer and one who received cash for his securities but already owned securities of the parent (as in *Portnoy*) or one who timely purchased securities of the parent thereafter (as in *Rothenberg*).[20]

Accordingly, there can be no meaningful distinction drawn between this case and the prior decisions of the other Courts of Appeals that have addressed this question, as well as prior decisions of the Second Circuit. Like the plaintiffs in *Portnoy* and *Rothenberg*, when Respondent lost his ownership interest in the issuer, he lost his standing to continue this action. Like the plaintiffs in *Portnoy*, *Lewis* and *Untermeyer*, the Respondent's ownership of securities of a parent of the issuer does not confer standing under the plain terms of the statute.

Therefore, the majority's holding that a shareholder of the issuer who loses that security and instead acquires a security of the parent corporation nevertheless continues to have standing, is inexorably in conflict with the plain language of Section 16(b) and the decisions of every other court that has addressed the issue (including the Second Circuit itself).

20 In *Rothenberg*, after being cashed out, the plaintiff purchased a security in the ultimate parent of the issuer in an effort to regain standing. The court did not decide whether this revitalized the plaintiff's standing because no demand had been made on the ultimate parent entity. *Id.* at 91,692-93.

CONCLUSION

For the foregoing reasons, the judgment of the Court of Appeals should be reversed, and the case should be remanded to the Court of Appeals with directions to affirm the order appealed from.

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